Senate File 2295 - Introduced

SENATE FILE 2295
BY McCOY and SCHNEIDER

A BILL FOR

An Act exempting from the computation of net income for the individual income tax the net capital gain from the sale or exchange of qualified capital stock and including applicability provisions.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF IOWA:

Section 1. Section 422.7, subsection 21, paragraph a, subparagraph (2), Code 2016, is amended to read as follows:

(2) For purposes of this ~~paragraph~~ subsection, *"lineal descendant"* means children of the taxpayer, including legally adopted children and biological children, stepchildren, grandchildren, great-grandchildren, and any other lineal descendants of the taxpayer.

Sec. 2. Section 422.7, subsection 21, Code 2016, is amended by adding the following new paragraph:

NEW PARAGRAPH. *f.* (1) The following percentage of the net capital gain from the sale or exchange of capital stock of a qualified corporation for which an election is made by an employee-owner:

(a) For the tax year beginning in the 2017 calendar year, fifty percent.

(b) For the tax year beginning in the 2018 calendar year, sixty percent.

(c) For the tax year beginning in the 2019 calendar year, seventy percent.

(d) For the tax year beginning in the 2020 calendar year, eighty percent.

(e) For the tax year beginning in the 2021 calendar year, ninety percent.

(f) For tax years beginning on or after January 1, 2022, one hundred percent.

(2) (a) An employee-owner is entitled to make one irrevocable lifetime election to exclude the net capital gain from the sale or exchange of capital stock of one qualified corporation which capital stock was acquired by the employee-owner while employed by such qualified corporation.

(b) The election shall apply to all subsequent sales or exchanges of the elected capital stock, provided it is capital stock in the same qualified corporation and was acquired by the employee-owner while employed by such qualified corporation.

(c) The election shall apply to transfers of the capital stock by inter vivos gift from the employee-owner to the employee-owner's spouse or lineal descendants, or to a trust for the benefit of the employee-owner's spouse or lineal descendants. This subparagraph division (c) shall apply to a spouse only if the spouse was married to the employee-owner on the date of the sale or exchange or the date of death of the employee-owner.

(d) If the employee-owner dies without making an election, the surviving spouse or, if there is no surviving spouse, the personal representative of the employee-owner's estate may make the election that would have qualified under subparagraph division (c).

(e) The election shall be made by including a written statement with the taxpayer's state income tax return for the taxable year in which the election is made. The written statement shall identify the qualified corporation that issued the capital stock, the grounds for the election under this paragraph *"f"*, a statement that the taxpayer elects to have this paragraph *"f"* apply, and any other information required by the department. The department shall provide appropriate forms for making elections and reporting exclusions pursuant to this paragraph *"f"*.

(3) For purposes of this paragraph:

(a) *"Capital stock"* means common or preferred stock, either voting or nonvoting. *"Capital stock"* does not include stock rights, stock warrants, stock options, or debt securities.

(b) *"Employee-owner"* means an individual who owns capital stock in a qualified corporation, which capital stock was acquired by the individual while employed by such corporation.

(c) *"Personal representative"* means the same as defined in section 633.3, or if there is no such personal representative appointed, then the person legally authorized to perform substantially the same functions.

(d) (i) *"Qualified corporation"* means a corporation which, at the time of the first sale or exchange for which an election is made under this paragraph *"f"*, meets the following conditions:

(A) The corporation has been in existence and actively doing business in this state for at least ten years.

(B) The corporation has at least five shareholders.

(C) The corporation has at least two shareholders or groups of shareholders who are not related. Two persons are considered related when, under section 318 of the Internal Revenue Code, one is a person who owns, directly or indirectly, capital stock that if directly owned would be attributed to the other person, or is the brother, sister, aunt, uncle, cousin, niece, or nephew of the other person who owns capital stock either directly or indirectly.

(ii) A qualified corporation shall include any member of an affiliated group, as defined in section 422.32, if the affiliated group includes a member that has been in existence and actively doing business in this state for at least ten years.

(iii) A qualified corporation shall include any corporation that was a party to a reorganization that was entirely or substantially tax free if such reorganization occurred during or after the employment of the employee-owner.

Sec. 3. APPLICABILITY. This Act applies to tax years beginning on or after January 1, 2017.

EXPLANATION

The inclusion of this explanation does not constitute agreement with the explanation's substance by the members of the general assembly.

This bill grants an employee-owner, as defined in the bill, one irrevocable lifetime election to exclude from state individual income tax the net capital gain from the sale of the capital stock of one qualified corporation.

The capital gain exclusion is phased in over a six-year period beginning with a 50 percent exclusion for tax years beginning in calendar year 2017, and increasing 10 percent each calendar year until the exclusion equals 100 percent for tax years beginning on or after January 1, 2022.

Several requirements must be met for capital stock to qualify as capital stock of a qualified corporation. First, the stock must be either voting or nonvoting, common or preferred stock. Stock rights, stock warrants, stock options, and debt securities do not qualify. Second, the corporation that issued the stock must be in existence and actively doing business in Iowa for at least 10 years. A corporation that is part of an affiliated group will qualify if the affiliated group includes a member that has been in existence and actively doing business in Iowa for at least 10 years. Third, the corporation that issued the stock must have at least five shareholders, two of whom must not be related. Fourth, the stock must have been acquired by the employee-owner while employed by the corporation. A corporation will qualify if it is a party to a reorganization that was entirely or substantially tax free as long as the reorganization occurred during or after the employee-owner's employment.

The election shall apply to all subsequent sales of the elected capital stock, provided it is capital stock in the same qualified corporation and was acquired by the employee-owner while employed by the corporation.

The bill provides that the election applies to transfers of the capital stock by inter vivos gift from the employee-owner to a spouse or lineal descendant, or to a trust for the benefit of the employee-owner's spouse or lineal descendant. The election will apply to a spouse only if the spouse was married to the employee-owner on the date of the sale or the date of the employee-owner's death.

If, after making a valid inter vivos transfer of stock that meets all the requirements for an election, an employee-owner dies without making an election, the surviving spouse, or if there is no surviving spouse, the personal representative of the employee-owner's estate may make the election.

An election is made by including a written statement containing certain required information, as specified in the bill, with the taxpayer's Iowa income tax return for the taxable year in which the election is made. The department of revenue is required to provide appropriate forms for making elections and reporting exclusions.

The bill applies to tax years beginning on or after January 1, 2017.